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Supreme Court of the United States

OCTOBER TERM, 1945

No. 69

LILLIAN BOEHM,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE.

PETITIONER'S BRIEF

LOUIS BOEHM,
Attorney for Petitioner.

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LILLIAN BOEHM,

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COMMISSIONER OF INTERNAL REVENUE.

PETITIONER'S BRIEF

Petitioner herein, the above named Lillian Boehm, presents for review the judgment of the U. S. Circuit Court of Appeals, for the Second Circuit, entered in the above case on February 10, 1945 (92) modifying the order of the Tax Court of the United States (68-69) which determined the presence of deficiencies in her 1936 and 1937 income tax returns.*

Opinions Below

The opinion in the Tax Court of the United States (62-68) is not officially reported. The opinion in the Circuit Court of Appeals is reported in 146 F. 2d 553.

Statement of Jurisdiction

The judgment of the Circuit Court of Appeals was entered February 10, 1945 (92). The jurisdiction of this Court was invoked under Section 240 (a) of the Judicial

* Figures in parenthesis refer to the pages of the printed transcript of record. Unless otherwise indicated, emphasis is ours.

Code as amended by the Act of February 13, 1925 (U.S. C.A. Title 28, Section 347a).

Certiorari was granted by this Court on June 11, 1945 on petitioner's application.

Statement of Case

The case having been submitted on an agreed statement of facts (20-24), no facts are in dispute.

In 1929 the petitioner purchased 1,100 shares of the Class A (or preferred) stock of The Hartman Corporation, an old established furniture house, hereinafter called Hartman, for $32,440 (20). On December 31, 1931, Hartman had total current assets as shown by its consolidated balance sheet of $8,978,091.22, and total assets of $15,401,097.97; current liabilities of $4,198,813.26, plus other miscellaneous liabilities, making total obligations of $4,740,438.47, leaving a net worth of $9,410,659.59, in addition to a reserve for contingencies of $1,250,000 (45-47). On May 4, 1932 Hartman advised its stockholders that borrowed moneys had been reduced by $575,000 since January 1, 1932, thereby reducing borrowed moneys to a new low since 1924 (48). In June, 1932, Martin L. Straus and Elias Mayer were appointed equity receivers for Hartman by the U. S. District Court for the Northern District of Illinois, Eastern Division. The receivers entered into possession of the property of Hartman and continued its business of buying and selling furniture and other household articles from the time of their appointment until May 26, 1933 (20, 38).

The bill of complaint requesting the appointment of equity receivers for Hartman alleged that the *corporation's assets were greater than its liabilities,* but that it was temporarily unable to meet its current obligations, and that by reason thereof, it prayed for the protection

of a court of equity and the appointment of equity receivers to take possession of its property and assets, and to continue its business (33). In the bill of complaint in said action, it was further alleged "that said assets upon thus being administered in a court of equity, through said receivership, will be sufficient to pay *in full* all liabilities against said defendant, and that *a surplus will be left for the benefit of defendant's stockholders*" (33). These allegations of the bill of complaint were admitted to be true by Hartman (38).

A suit against the directors of Hartman, hereinafter called the Graham suit, was instituted on December 16, 1932 in the Supreme Court of the State of New York. The petitioner and eight other stockholders of Hartman were plaintiffs. The defendants were the corporation, Hartman, and nine directors. The plaintiffs brought the suit "on behalf of themselves as stockholders of the Hartman Corporation and on behalf of the said Company and all other stockholders of said Company similarly situated, who may join with the plaintiffs in, and contribute to the expenses of, this suit" (55). The complaint charged the defendants with waste and mismanagement and demanded that the defendants render an accounting and pay into the treasury of the corporation the amount of the loss and damage sustained by it by reason of their wrongful acts (61). More specifically, the complaint alleged that during the years 1929 and 1930 the directors and officers of Hartman caused it to purchase in the open market, for cash, 64,789 shares of its Class B, or junior, stock at an average cost of $22 per share and an aggregate cost of approximately $1,422,000 (58). The complaint alleged that part of this Class "B" stock was purchased by the corporation from the individual directors and officers (59). It was also alleged that the directors, without the knowledge of the stockholders, caused the corporation thereafter to sell the Class "B"

stock to its employees (including its officers and directors), at a price of $16 per share, $6 per share less than the cost of the stock to Hartman, with an agreement by the corporation to repurchase the stock, *at the option of the purchasers,* at the cost to them of $16 per share. The corporation repurchased large amounts of the stock at the price of $16 per share (59-60). Thereafter, the stock became worthless. The entire amount of $1,422,000 expended for the stock was lost (58-60).

It is interesting to compare the corporation's loss on the 64,879 shares of stock purchased by it, aggregating $1,422,000, with the total liabilities of the corporation amounting to $630,574 (23) at the termination of the equity receivership. The recovery on this single element of wrongdoing, exclusive of all other acts of mismanagement, would have been more than twice the total of all the liabilities of the corporation. A substantial equity therefore remained for the stockholders in the cause of action against the directors.

In 1933 a new corporation called Hartman's, Inc. was organized under the laws of the State of Delaware (20). As of May 26, 1933 Hartman's, Inc. purchased at a bankruptcy sale the assets of Hartman Furniture and Carpet Company, a wholly owned subsidiary of Hartman, for the sum of $501,000 in cash and an agreement to procure a waiver of certain inter-company claims against the bankrupt estate. The stock of the new company was issued to the creditors of Hartman Furniture and Carpet Company in settlement of claims, and to the stockholders of Hartman by subscription thereto. The stockholders of Hartman were given the right to subscribe for debentures and stock of Hartman's Inc. in 1933. Petitioner did not exercise her right of subscription (21).

On August 10, 1934, the receivers of Hartman filed a report with the court listing as assets $39,593.13 in cash

and *a suit pending against the directors* (the Graham suit), and as liabilities total outstanding claims amounting to $707,430.67. The receivers recommended that claims totalling $630,574.57 be allowed. The Court approved this report (21). The receivers filed a second report on July 11, 1935, listing as assets $27,192.51 in cash *and the Graham suit pending against the directors,* and as liabilities the aforesaid claims. The receivers recommended that a dividend of 4 per cent be paid on the claims of $630,574.57 allowed, which was paid (21).

The Graham suit was vigorously prosecuted. During the years 1933 to 1936, inclusive, examinations before trial of certain of the directors were held from time to time in New York City. Petitioner's counsel also went to Chicago, Illinois, during this period and spent four days there on the examination before trial of certain of the defendants who resided in that City (22). In the course of such examinations before trial, many hundreds of pages of testimony were taken and numerous exhibits were offered in evidence (22). Petitioner and the other plaintiff stockholders were ordered by the New York Supreme Court to pay the counsel fees, transportation and hotel expenses of the *defendants'* New York counsel who traveled to Chicago and represented said defendants on such examinations (22). Such counsel fees and expenses of defendants' counsel amounted to approximately $800 (22). Petitioner and the other plaintiff stockholders also paid the transportation and hotel expenses of their own counsel in attending upon such examinations, as well as the fees of the stenographer who reported the testimony, and also paid the fees of the commissioner before whom the examinations were held (22). Petitioner and other plaintiff stockholders also paid for the cost of printing briefs in the Appellate Division of the New York Supreme Court on an appeal which defendants had taken to such Court (22-23). The amount of disbursements paid by

petitioner and the other plaintiff stockholders, exclusive of the fees of their own counsel, amounted to approximately $2,800 (77).

At the conclusion of the examinations and shortly before the trial, negotiations were commenced for a settlemen of the action, and on February 20, 1937 such settlement was consummated (23). Under its terms the defendant directors paid the petitioner and the other plaintiff stockholders the sum of $50,000 in full settlement and discharge of the claims of the petitioner and of her co-plaintiffs.* In connection with the settlement the petitioner and the other stockholders released all their rights and claims arising out of the acts committed by the defendants as alleged in the complaint. The suit was thereafter dismissed on May 14, 1937 (23).

After the settlement of the Graham suit the receiver filed a final report with the court on September 30, 1937, and he was thereafter discharged by an order dated September 30, 1937 (21-22).

Petitioner's proportionate share of the $50,000, after payment of counsel fees and expenses, amounted to $12,500. In her income tax return for 1937 she claimed a deduction from gross income in the amount of $19,940, being the difference between $32,440, the cost of the stock, and $12,500, the amount of her recovery, as a loss due to the worthlessness of her Hartman stock. The Commissioner denied the deduction and included as ordinary income in that year the sum of $12,500, which she had received pursuant to the settlement (23). The Tax Court affirmed his determination. The Circuit Court of Appeals

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* Under the law of New York, in which State the action was brought, petitioner and those who joined with her had the right to effect settlement of their individual claims to damages. *Manufacturers Mutual Fire Ins. Co.* v. *Hopson*, 176 Misc. 220, aff'd 262 App. Div. 731, aff'd 288 N. Y. 668.

reversed in part, and held that the $12,500 constituted a capital item in reduction of petitioner's loss and was, therefore, not taxable as income. However, it held that the balance of $19,940, representing the unrecovered cost, was a loss which could not be deducted in 1937, on the ground that the Hartman stock had become worthless prior thereto (80).

The pertinent statute and regulations involved are printed in the appendix attached.

Specifications of Errors

Petitioner urges that the Circuit Court of Appeals erred in holding

(1) that the objective test was solely to be used in determining the year in which the stock became worthless, and that the taxpayer's honest belief, as shown by her conduct in vigorously prosecuting the Graham suit to a successful conclusion, was not to be considered;

(2) that the decision of the Tax Court, when based on an agreed statement of facts, constitutes a determination of fact and not of law.

(3) that under the objective test the stock became worthless prior to 1937.

Summary of Argument

I. The Court below erred in holding that the taxpayer's reasonable and honest belief, the correctness of which was confirmed by events, that her stock was not valueless until the action brought by her had been settled and her rights released, was not to be considered in determining when the loss was deductible.

II. The decision of the Tax Court on an agreed statement of facts constitutes a determination of law.

III. Even viewed objectively, petitioner's stock in Hartman Corporation did not become worthless until the petitioner's action was settled and her claim released.

POINT I

The Court below erred in holding that the taxpayer's reasonable and honest belief, the correctness of which was confirmed by events, that her stock was not valueless until the action brought by her had been settled and her rights released, was not to be considered in determining when the loss was deductible.

The cause of action against the directors was an asset owned by the Corporation. It constituted property, just as much as a building or machinery or any other form of tangible property. Until the cause of action was terminated, insofar as petitioner's interest therein was concerned, it could not be determined that taxpayer's stock was worthless, or even whether there would be a loss thereon, or what that loss would be. Whether there would be a loss, and the amount of the loss, was ascertained for the first time when the settlement was reached

in 1937. That taxpayer honestly believed that her stock had not become valueless and that the cause of action which she and the other stockholders were prosecuting had merit, is demonstrated by the conceded facts.

It was stipulated in the Tax Court that extensive services were rendered in the prosecution of the Graham suit over a period of four years from 1932 to 1937 (22-23).

The action was commenced in 1932 by petitioner and eight other stockholders to recover for the waste and mismanagement of Hartman. On one count alone, namely, the purchase by Hartman of its junior shares at a cost of $1,422,000 (stock which subsequently became completely worthless), the recovery would have been about $800,000 in excess of creditors' claims. Other causes of action were set forth in the complaint, such as payment of extravagant salaries, making of improvident contracts, etc. (58). The stipulation concedes that the suit was vigorously prosecuted. Petitioner's counsel spent four days in Chicago in examining certain defendants who resided in that city (22). Certain of the defendants were examined in New York (22). Many hundreds of pages of testimony were taken and numerous exhibits offered (22). Petitioner and the other complaining stockholders were required to, and did, pay the fees of various New York counsel for defendants in attending the examinations in Chicago, as well as their traveling and hotel expenses, and those of their own counsel (22). They paid the fees of the Commissioner before whom the depositions were taken, as well as those of the stenographer who took them (22). They paid for the printing of briefs on appeal to the Appellate Division of the New York Supreme Court. Petitioner and her co-plaintiffs paid disbursements of approximately $2800, exclusive of fees of their own counsel, in the prosecution of the action (77). Peti-

tioner's good faith and confidence in the litigation which she had brought against the directors was therefore attested by its vigorous prosecution over a period of years, as well as by the payment of substantial disbursements in the prosecution of the action, and her willingness to incur substantial counsel fees for her own counsel in connection with extensive services rendered. Under those circumstances, we respectfully submit that petitioner should have been permitted to deduct her loss on the stock in the year in which she believed, and had a right to believe, it had become worthless, and in which in fact it ceased to have further value owing to her settlement of the case and the release of her cause of action.

In *Smith* v. *Helvering*, 141 F. (2d) 529, which the Court below refused to follow, the Court of Appeals for the District of Columbia held that the taxpayer's opinion and belief, as evidenced by his acts, are decisive of the year in which a worthless stock loss should be taken. In that case the Commissioner determined a deficiency against the taxpayer for the calendar year 1937. The taxpayer deducted a loss on certain stock of San-i-Sal Laboratories, Inc., in that year. It was shown that the corporation's business was suspended early in 1929 and that thereafter it had no full time employees and filed no Federal income tax return. It was shown that from 1925 to 1937 the petitioner advanced funds on behalf of the corporation. In 1937 a Certificate of Dissolution was filed with the Secretary of State of Delaware. *It was not disputed that the corporation was insolvent prior to 1937.* The Board of Tax Appeals stated that "the loss must be taken in the year in which it was sustained and at no other time" and this means the year in which these shares in every substantial and realistic way became worthless. In reversing the Board of Tax Appeals, the Court, per Justice Miller, stated at page 530:

"We think the decision of the Board too severely restricted the taxpayer and sets too high a standard of industrial performance; especially in light of the remarkable industrial developments often achieved by courageous and optimistic American businessmen, who refused to be dissuaded when bankers and other conservative citizens advised that their enterprises were worthless in 'every substantial and realistic way.' Henry Ford is a striking example. Even though, perhaps, a businessman should not be encouraged to be an incurable optimist, if he is one, nevertheless, and continues to express his optimism by putting money into an insolvent organization, he should be given the benefit of the doubt. This would seem to be particularly true where, as here, the suspension of business occurred in 1929, the year of the great panic, and the transfusions administered by the taxpayer occurred during the period of the most severe depression ever experienced in this country.

"The case which comes closest in its facts to the present case is *Rassieur* v. *Commissioner* [129 F. 2d 820]. The nub of the decision appears in the following language: 'So long as taxpayer was willing to protect or pay the company debts and to advance funds for its current expenses, no one could say that any "identifiable events" had occurred which finally determined the worthlessness of the stock.' The language of that opinion which immediately precedes the statement quoted is remarkably apt: 'The panic struck this, as all other business, like a blight. Its business decreased and its owned securities diminished drastically in market value while expenses and indebtedness continued. In the endeavor to weather the storm and continue the business, various steps were taken, such as progressive restriction of business, curtailment of expenses, and sale of the "market service." It is evident that there was no time from 1931 to dissolution when it could have converted its assets, paid its debts and had anything remaining for stock value if it had been compelled to rely only upon its own resources and to liquidate. From the latter part of 1931, it could not have continued in business or paid

its debts when due if it had been compelled to rely solely upon its own resources. However, the actual fact was that it did not have to so rely on its own resources alone. While there was neither legal nor moral obligation so to do, yet there were strong reasons of self-interest and probably of sentiment (help to his son) which impeled Theodore Rassieur to come to the financial aid of the company and he did so. The sole purpose of these two reasons was the same—to preserve the business. Unless that could be done, the taxpayer stood to lose at least the $250,000 he had contributed (for himself and the two others) to the capital stock; and his son would be out of business. The mere winding up of this business would have defeated the purpose entirely. There can be no question that this purpose to preserve the business was the dominant moving consideration of these three men, who held all of the capital stock, during this entire period. The accomplishment of the purpose depended entirely upon the willingness of taxpayer to make advances. As long as he continued willing, the business would last. As long as it lasted, there was a prospect of its successful survival.' "

The Court then specifically held that the test that should be applied in determining the year in which the stock became worthless was a *subjective* and not an *objective* standard. The Court said, at p. 531:

"The test proposed by the Board in the present case is a highly objective one which disregards what the taxpayer may think of his investment, how much of an optimist he may be, or what he may consider to be the possibilities of future successful operation, or of eventual recoupment. An examination of the cases persuades us that the subjective appraisal of the taxpayer is of much greater importance. The Supreme Court said as much in *United States* v. *S. S. White Dental Manufacturing Company* [274 U. S. 398]. In *Forbes* v. *Commissioner*, Judge Parker, speaking for the Court of Appeals of the Fourth Circuit and reversing a decision of the Board in a similar case

used the following language: 'Practical considerations must govern, for it is as true here as in Lucas v. American Code Co., 280 U. S. 445, 449, * * * that: "No definite legal test is provided by the statute for the determination of the year in which the loss is to be deducted. The general requirement that losses be deducted in the year in which they are sustained calls for a practical, not a legal test." * * * As said by Judge Learned Hand in de Loss v. Commissioner (C. C. A. (2d) 28 F. (2d) 803, 804), "So far as *human foresight* could go, the shares were worthless, and the petitioner might have deducted the loss." We are not dealing with a case where *there was hope* that a business although involved *might be saved* and value in the stock established. *Hope* had been abandoned and *liquidation had been ordered.*' (Italics supplied.) In *Lucas* v. *American Code Company,* the Supreme Court pointed out that the test which should be applied is a practical and not a legal one. In that case the loss which was paid by the taxpayer in 1923 resulted from a breach of contract which occurred in 1919. The Court upheld a determination of the Board that the deduction could not be taken in 1919 because of the various possibilities which then existed affecting the amount of the recovery which might be, eventually, obtained against the company. Among other things the Court listed, as evidencing the attitude of the taxpayer, that it did not accrue on its books during the tax year of 1919 any liability in the estimated amount of the loss; and that reserves set up by the taxpayer during that year bore no relation to the apprehended loss. The Court concluded by saying: 'It cannot be said that the loss actually paid by the Company in 1923 was, as a matter of law or of undeniable fact, sustained in 1919. *Nor did the Company so regard it.*' (Italics supplied.) If the taxpayer's attitude is a proper subject of appraisal in one case it should be in another. Similarly, in *Benjamin* v. *Commissioner* [70 F. 2d 719], a subjective test was applied. It was held that the mere shutting down of a mill and suspension of business—other than prospecting for additional soapstone deposits—was not sufficient to show a complete loss;

and this in spite of the fact that no deposits were actually uncovered. The court held that while *hope* and *possibility of success* remained, proof of loss was not complete. In the present case, if we reason from the taxpeyer's attitude, hope had not been abandoned and possibility of success remained."

In the instant case, the petitioner did not believe that her stock was worthless prior to 1937. No other inference can be drawn from the conceded facts. Petitioner and the other stockholders who were plaintiffs in the Graham suit employed counsel and advanced substantial sums of money in prosecuting what they considered a meritorious cause of action on behalf of the corporation. Expenditures, exclusive of counsel fees, amounted to approximately $2,800. Would the petitioner and the other plaintiff stockholders have spent at least $2,800 for disbursements, in addition to counsel fees, for the very extensive services which were being rendered in prosecuting this cause of action, had they considered the stock worthless? So long as the petitioner asserted her rights as a stockholder, and spent substantial sums of money in asserting them, we do not believe it can reasonably be inferred that she believed her stock to be worthless.

We do not contend that the *subjective* test should be based merely upon the unsupported opinion or belief of the taxpayer. However, where there is a reasonable basis for the taxpayer's belief that his stock has not become worthless, and the honesty of that opinion is evidenced by affirmative conduct on the part of the taxpayer which is irreconcilable with a contrary conclusion, then we respectfully submit that the *subjective* test as to when the stock has become worthless is the proper test to be applied. This is particularly true when, as in the instant case, *the taxpayer's opinion was by the actual course of events demonstrated to be correct.* The recovery by the taxpayer, and the other plaintiffs in the Graham suit, of the sum of

$50,000 in 1937 demonstrates the correctness of the taxpayer's opinion that her stock had not become worthless prior to that year.

A case directly in point is the case of *Louisville Trust Company* v. *Glenn*, 33 F. Supp. 403 (aff'd 124 F. 2nd 418, C. C. A. 6th). In that case an agent made an unauthorized investment in stock which became worthless in 1930, and principal's committee, appointed in January, 1931, promptly repudiated the investment and demanded return of the money so invested and employed attorneys to enforce the claim against agent. The Court held that the loss resulting from the unauthorized investment and the committee's recoupment therefor were merely separate phases of a single continuous transaction which was not completed until the net loss was determined by acceptance of the compromise payment in 1933, and therefore the net loss was a proper deduction in determining principal's taxable income for 1933. The Court in its opinion adverted to the fact that in the cases in which the courts had held that the loss must be taken in an earlier year, "the taxpayer had no reasonable hope at the time of the loss of any eventual recoupment" (p. 408). In its very interesting opinion, the Court among other things, said:

> "The defendant's theory of treating the loss which occurred in 1930 as an entirely separate and distinct transaction from the recovery later obtained from the Trust Company has some support from the decisions of the Supreme Court in United States v. S. S. White Dental Mfg. Co., 274 U. S. 398, and Burnet, Commissioner v. Sanford & Brooks Co., 282 U. S. 359. Those cases held that the fact that a taxpayer recovers a small part of a loss in a subsequent year does not invalidate the loss for the year taken when its deduction was based on the exercise of reasonable judgment from facts then known; and that such later recovery becomes a part of the gross income of the year of its receipt. See, also, Rhodes v.

Commissioner, 6 Cir., 100 F. 2d 966. But that rule is based upon the fact that the *taxpayer had no reasonable hope at the time of the loss of any eventual recoupment. Where the facts giving rise to the loss are at the same time the basis for a substantial recoupment,* and reasonably recognized as such, it is only common sense to treat the loss taken as the difference between the value of the property lost or destroyed and the amount recovered. As a practical matter no loss is 'taken' until the amount of the recovery has been determined, provided the initial loss and the recovery are parts of the same transaction. It was held in Dresser v. United States, supra (55 F. 2nd 499), that a loss resulting to a taxpayer through ownership of stock in a corporation being liquidated was not deductible in the year 1919 where it appeared that a subsequent and final liquidating dividend uncertain in amount was reasonably anticipated even though delayed for several years. In that case the liquidation was substantially completed by December 31, 1919, and an estimate made of the final credit to be later received, which was not actually received until May, 1924. It was held that the net loss was a deductible item for the year 1924, and not for 1919 as claimed. If a loss results from the destruction of property which is accompanied by salvage, the net loss is not ascertained until the value of the salvage has been determined. Deductible losses must be evidenced by closed and completed tranactions, fixed by identifiable events. Lucas, Commissioner v. American Code Company, 280 U. S. 445; Central Trust Co. v. Burnet, Commissioner, 60 App. D. C. 4, 45 F. 2d 922; Ewing Thomas Converting Co. v. McCaughn, Collector, 3 Cir., 43 F. 2d 503. In the present case it is a disregard of the admitted facts to say that Pirtle's Committee in 1931 considered the Banco Kentucky Company investment a total loss, *or that it had no reasonable hope of a substantial recoupment* from the Trust Company. It promptly repudiated the investment and demanded the return of the money so invested. It employed attorneys to enforce the claim. It refused to compromise its claim at any time for less than 76 cents on the dollar. The claim was

never abandoned and the matter was never a closed or completed one until the settlement was reached in 1933. As was said in Rhodes v. Commissioner (6th Circuit), supra (100 F. 2d 969), 'Common sense interpretation is the safest rule to follow in the administration of income tax laws.' The common-sense interpretation of the present case is that the loss resulting from the unauthorized investment and the committee's recoupment therefor were merely separate phases of a single continuous transaction and that the matter was not a closed or completed transaction until the net loss was determined by the acceptance of the compromise payment in 1933."

The facts in the instant case are almost identical with those in the *Glenn* case, *supra*. In the present case the petitioner and her co-plaintiffs promptly asserted their rights by commencing an action within a few months after the appointment of the equity receivers of Hartman Corporation. Paraphrasing the language of the Court in the *Glenn* case, "it is a disregard of the admitted facts to say that petitioner and her co-plaintiffs considered their investment in Hartman Corporation a total loss or that they had no reasonable hope of a substantial recoupment in the suit against the directors. Petitioner and her co-plaintiffs employed attorneys to enforce their claim. In addition, they spent substantial sums of money in prosecuting their action. They refused to compromise the claim for less than a substantial amount. The claim was never abandoned and for that matter was never a closed or completed one until the settlement was reached in 1937."

The Board of Tax Appeals has repeatedly applied the subjective test in determining when stock has become worthless. In *Sterling Morton* v. *Commissioner*, 38 B. T. A. 1270, the Board said that "stock may not be considered worthless even when having no liquidating value if there is a reasonable *hope* and *expectation* that it will become valuable at some future time." The hope and expecta-

tion to which the Board of Tax Appeals referred necessarily meant the hope and expectation of the taxpayer. So long as the taxpayer had hope and expectation of ultimate recovery, provided that such hope and expectation was not chimerical and without basis, the stock still had potential value and had not become worthless. This is the application of the subjective test.

In the *Sterling Morton* case, *supra*, the Board of Tax Appeals said at page 1278:

> "• • • a loss by reason of the worthlessness of stock must be deducted in the year in which the stock becomes worthless and the loss is sustained, that stock may not be considered worthless even when having no liquidating value *if there is a reasonable hope and expectation that it will become valuable at some future time*, and that such hope and expectation may be foreclosed by the happening of certain events such as the bankruptcy, cessation from doing business or liquidation of the corporation, or the appointment of a receiver for it. Such events are called 'identifiable' in that they are likely to be immediately known by everyone having an interest by way of stockholdings or otherwise in the affairs of the corporation, but, regardless of the adjective used to describe them, they are important for tax purposes because they limit or destroy the potential value of stock • • •. If the assets of the corporation exceed its liabilities, the stock has a liquidating value. *If its assets are less than its liabilities but there is a reasonable hope and expectation that the assets will exceed the liabilities of the corporation in the future, its stock, while having no liquidating value, has a potential value and cannot be said to be worthless.* The loss of potential value, if it exists, can be established ordinarily with satisfaction only by some 'identifiable event' in the corporation's life which puts an end to such hope and expectation."

In *re William E. Templeman*, 20 B. T. A. 493, the Board of Tax Appeals also applied the subjective test as to when

stock became worthless. In that case it based its decision that the loss did not occur in the year claimed by the Commissioner on the fact that "the petitioner was expending time and money in an effort to save the corporation, and he must have had *hopes* of realizing something from his investment." The petitioner had bought large amounts of stock in an oil company in which he was heavily interested. A dispute arose in the latter part of 1920 and early 1921 as to the control of the company. The opposing group procured the filing of an involuntary petition in bankruptcy. Late in 1921, petitioner had this petition vacated on the ground that the proceeding was collusive. Petitioner then had a receiver appointed, and the opposing interest in the corporation and the receiver proceeded to operate the business of the corporation. Numerous other suits were filed by or against petitioner, the receiver and the corporation. In 1922 no funds were available in the hands of the receiver, and petitioner and the opposing group were without money to continue the litigation. At that time the corporation owed debts of $85,000, which it could not pay. Petitioner took the loss as a worthless security in 1922. The commissioner claimed it should have been taken in 1921, when the Corporation was put into bankruptcy. The Board of Tax Appeals held that the loss was sustained in 1922, saying at page 495:

> "The respondent has determined that the stock became worthless in 1921, apparently upon the ground that the company was declared a bankrupt in that year. The evidence is clear, however, that the adjudication in bankruptcy was irregular, and that it was vacated.
>
> "*Throughout 1921 the petitioner was expending time and money in an effort to save the corporation, and he must have had hopes of realizing something from his investment.* In 1922 it was clear that his stock was worthless, and he so determined when he deducted the amount on his income tax return for that year. The respondent erred in disallowing the deduction claimed."

In the instant case petitioner and other stockholders of Hartman not only expended time and money in the hope of ultimately recovering, but *actually succeeded in recovering a substantial part of the cost of their stock.*

In *William H. Redfield,* 34 B. T. A. 967, 971, *supra,* the question was whether stock in Caro Process Corporation should be determined as worthless in 1932, as petitioners claimed, or in 1931. The Caro Cloth Corporation had a contract with the Caro Process Co. whereby Caro Cloth Corporation licensed the use of certain machinery. A controversy arose between the two companies as to the quality of the machinery; as a result Caro Process Corporation sued Caro Cloth Co. in 1930 to recover payments made on the machine. This suit was dismissed for lack of prosecution in 1931. On dismissal of this suit in 1931 one of the petitioners, a stockholder of Caro Process, started negotiations with the President of the Caro Cloth Co. in behalf of Caro Process to recover something for Caro Process Corporation. In the fall of 1932, the last settlement conference was held, and petitioner Biggs was informed that there was no chance of settlement because of the bad financial conditions of Caro Cloth Co. It was held that the loss was deductible in 1932 "as petitioners believed in good faith that something would be recovered." The Board of Tax Appeals said at p. 971, *supra*:

> "The respondent contends that the identifiable event which fixed the date of the losses in controversy here occurred in 1931, when the suit instituted by the Process Corporation against the Caro Cloth Co. was dismissed for lack of prosecution. Petitioners argue that the losses could not be said to have been sustained at that time for the reason that thereafter there was reasonable expectation of effecting recovery of a substantial amount of their investments through friendly negotiations with the President of the Caro Cloth Co. These negotiations were concluded late in 1932, at which time all hope of recovery was abandoned.
>
> "From a careful consideration of the evidence, we are of the opinion that the contention of the peti-

tioners on this point must be sustained. At the end of 1931 it could not be said that the losses of these petitioners were complete. The circumstances as they existed at that time undoubtedly indicated a strong probability that there would be some loss, but negotiations were being actively carried on with a view to the recovery in one form or another of at least a portion of the petitioners' investments. *Apparently petitioners believed in good faith that something would be recovered,* and the situation, we think, reasonably supported such belief. Except for the financial difficulties encountered by the Caro Cloth Co. in 1932, the negotiations conducted by Biggs would have probably resulted in saving a substantial amount of the petitioners' investments. When those negotiations definitely failed during the taxable year solely because of the bad financial condition of the Cloth Company, the stock of the Process Corporation became worthless, and this event fixed the date of the petitioners' losses."

In the instant case, petitioner's action was vigorously prosecuted from 1933 to 1937. Petitioner in good faith believed that something would be recovered on her stock. The settlement negotiations were actually fruitful, resulting in the petitioner recovering $12,500, after the payment of counsel fees and expenses.

The difference between the application of the so-called subjective as distinguished from the objective test as to when stock becomes worthless appears to rest mainly in the fact that in the application of the subjective test the reasonable belief, expectation and conduct of the taxpayer are taken into account, whereas in the application of the so-called objective test the transaction is viewed not as it would appear to a reasonable person at the time, but only in the light of subsequent events. We respectfully submit that what the taxpayer honestly thought at the time concerning the value of his investment, particularly when he acted upon that belief and expended money and effort in attempting to salvage his investment, is the test which

should be applied in determining when his stock has become worthless. The so-called objective test, in essence, is the test of hindsight. It disregards what a prudent person would have thought and done at the time, and views the transaction solely in the cold light of subsequent events. It is an old axiom that hindsight is better than foresight. It would, however, be grossly unfair to a taxpayer, struggling to salvage a loss, to hold that his honest and reasonable belief of reducing his loss would be of no avail to him taxwise if by hindsight it could be said that his efforts might not be successful.

In the instant case, however, *the taxpayer's belief that her stock had not become worthless was by the actual course of events demonstrated to be correct.* So that even by the application of the objective test, namely, the *test of hindsight,* the taxpayer's stock had not become worthless prior to 1937, when she obtained her recovery and released her rights.

It is true that petitioner attempted to deduct her loss on the Hartman stock in the year 1934. From this circumstance the court below inferred that petitioner then thought her stock to be worthless (78). However, the court below itself recognized the dilemma in which taxpayers often find themselves as to when the loss should be taken on a worthless security, and in *Young* v. *Commissioner,* 123 F. (2d) 597, 600, said:

> "In cases like this the taxpayer is at times in a very difficult position in determining in what year to claim a loss. The only safe practice, we think, is to claim a loss for the earliest year when it may *possibly* be allowed and to renew the claim in subsequent years if there is any reasonable chance of its being applicable to the income for those years."

Petitioner did no more than to adopt "the only safe practice", suggested by the court below. Furthermore, the inference which the court below drew is contradicted

by the conceded fact that after 1934 petitioner for three years continued vigorously to prosecute her lawsuit and to expend substantial sums of money thereon. This is irreconcilable with the inference that petitioner had abandoned all expectation of recovery.

The court below also stated that the fact that other stockholders did not intervene in the Graham suit was not without significance. The court below, however, was unaware of the circumstances (a) that other stockholders did seek to intervene, but that their application was denied; and (b) that other stockholders did actually commence their own action in the New York Supreme Court against the Hartman directors, which action was also settled at about the same time that the Graham suit was settled. While it is true that these facts do not appear in the record, yet it is also true that the contrary does not appear. There is no support in the record therefore for the mistaken assumption by the court below that other stockholders had not sought to assert their rights (78).

Likewise, the court below was influenced by its assumption that the equity receivers were not interested in prosecuting the cause of action (78). The court below, however, overlooked the fact that that lack of interest was due not to lack of merit in the cause of action but to the adverse interest of the equity receivers. The equity receivers were Martin L. Straus and Elias Mayer (20). Martin L. Straus was the President, a director, and the moving spirit of the Hartman Corporation, and a principal defendant in the Graham suit (88). He could not, therefore, be expected to prosecute the Corporation's suit against himself. Elias Mayer was Straus's lawyer and it would be unreasonable to expect that he would prosecute a cause of action against his own client. In fact, Mayer was a defendant in the other stockholders' action instituted in the New York Supreme Court, which

was likewise settled (88). As was stated by the court in *Norman* v. *Federal Mining & Smelting Co.*, 180 App. Div. 325, at page 335:

> "It is not to be assumed that they (the directors) would prosecute in good faith an action based on their own misconduct."

Hence, the fact that the equity receivers did not prosecute the corporation's cause of action against the directors is wholly without significance in appraising the value of the Graham suit.

POINT II

The decision of the Tax Court on an agreed statement of facts constitutes a determination of law.

The Court below construed the decision of the Tax Court that petitioner's stock did not become worthless in 1937 as a determination of fact that it could reverse only if unsupported by substantial evidence (77). We do not question the general rule, but we respectfully submit that it has no application where the facts are conceded.

The within case was submitted to the Tax Court on an agreed statement of facts. Where the facts are conceded, the decision of the Tax Court constitutes a determination of law and not of fact. Where a case is submitted on agreed facts, the Court to which it is submitted makes no findings of fact. In such case the Court is required to determine only the legal consequences arising from the undisputed facts. Such a decision constitutes a conclusion of law and not of fact.

The Court below therefore was mistaken in assuming that it could not review the determination of the Tax Court because it was a determination of fact. The decision of the Tax Court constituted a determination of law

which was reviewable in the Court below, as well as in this Court.

In *G. E. Employees Securities Corporation* v. *Manning*, 137 F. 2d 637, (C. C. A., 3rd), an action to recover monies paid on a deficiency assessed by the Commissioner, was tried without a jury and on a stipulation of facts. The Court said at page 639:

> "Since the facts are not in dispute, and indeed were stipulated, the conclusions drawn from these facts are subject to appellate review" (citing cases). "The issue before us is whether the District Court's conclusion from the stipulated facts, that the Company's stock was worthless prior to 1936 is correct."

In *Exmoor Country Club* v. *United States*, 119 F. 2nd 961 (C. C. A. 7th), the Court at pages 841 and 842, said:

> "In this case the facts are not in dispute. The problem is one of construction, i. e., the application of the Taxing Statute. In such situations where the ultimate finding is a conclusion of law or at least a determination of a mixed question of law and fact, it is subject to judicial review, and on such review the appellate court may substitute its judgment for that of the trial court. Bogardus v. Commisioner, 302 U. S. 34, 39, and Deputy et al. v. Du Pont, 308 U. S. 488, 499."

In *Feist v. Fifth Avenue Bank*, 280 N. Y. 189, the New York Court of Appeals at page 190, said:

> "This case having been submitted on agreed facts pursuant to Section 546-548 of Civil Practice Act, the Appellate Division was without power to draw inferences of fact. The question presented is whether the judgment correctly defines the effect of the stated facts as a matter of law, not whether there is any evidence upon which supported findings could have been made." Lafrinz v. Whitney, 233 N. Y. 107; Title Guarantee & Trust Co. v. Mortgage Commission, 271 N. Y. 302.

POINT III

Even viewed objectively, petitioner's stock in Hartman Corporation did not become worthless until the petitioner's action was settled and her claim released.

According to the conceded facts, a cause of action accrued to Hartman Corporation against its officers and directors for the damage it had sustained arising from the purchase of its junior stock (some of which was purchased from the officers and directors themselves), as a result of which the corporation lost $1,422,000, the entire amount expended for the stock (58). In addition other causes of action were alleged for payment of extravagant salaries, wasteful management, *etc.* These causes of action constituted a valuable asset of the corporation. If successfully prosecuted, they would net an amount far in excess of the claims of creditors. The causes of action were vigorously prosecuted over a period of more than four years. Extensive services were rendered and substantial sums of money expended in their prosecution. The good faith of petitioner and her co-plaintiffs in prosecuting that action has not been, and cannot be, questioned. The action was not compromised for a sum which represented merely nuisance value. It resulted in a substantial recovery. After payment of counsel fees and expenses, petitioner recovered approximately 40% of the cost price of her stock. Even viewed objectively, how can it be said that this stock had become worthless before the settlement was made?

The cases are quite uniform in holding that whenever a transaction gives rise to litigation neither party to the transaction realizes income or sustains a loss from that transaction until the litigation is finally settled or determined.

Morton v. *Commissioner*, 104 F. (2d) 534;
Re Russel Wheel & Foundry Co., 3 B. T. A. 1168;

William E. Templeman, 20 B. T. A. 493;
William H. Redfield, 34 B. T. A. 967;
Re George C. Peterson Co., 1 B. T. A. 690;
Cooley Butler v. *Commissioner*, 45 B. T. A. 593;
Sterling Morton v. *Commissioner*, 38 B. T. A. 1270;
Sabath v. *Commissioner of Internal Revenue*, 100 F. (2d) 569.

In *Morton* v. *Commissioner*, 104 F. (2d) 534, *supra*, the taxpayer deducted a loss sustained on the foreclosure of a deed of trust on certain property in 1934. The taxpayer and another had jointly purchased the property in 1912 for $45,000. In 1923, they jointly borrowed $25,000 from the North Carolina Joint Stock Land Bank and gave the latter, as security, a deed of trust on the property. In 1931 at the Bank's request, the trustee named in the deed of trust advertised the property for sale at public auction, and it was sold on January 9, 1932, being bought in by the trustee. Later two actions were commenced. The taxpayer sued to enjoin the trustee from executing a deed to the purchaser, claiming that the sale was null and void, and the Bank sued the taxpayer to recover a deficiency of $11,143.38. In the taxpayer's answer in the latter action, he set up as a defense the same facts which formed the basis of his injunction action. Before the suits were reached for trial, they were settled by taxpayer paying to the Bank $2,500. Taxpayer took the loss in the year of the settlement. The Commissioner held that the loss occurred in 1932 at the time of the foreclosure sale. The Board of Tax Appeals upheld the Commissioner and disallowed the loss. The Circuit Court of Appeals, 4th Circuit, reversed, saying (p. 536):

> "• • • The final settlement of this litigation was the determinative event which fixed the time of the loss. • • •
>
> "It has been held in numerous cases that whenever a transaction between two parties gives rise to claims

and counterclaims, and litigation ensues involving the rights and claims of both, neither party sustains a loss or realizes income from that transaction until the litigation is finally determined, or settled by agreement of the parties. Consolidated Tea Company v. Bowens, D. C., 19 F. 2d 382; Ewing Thomas Converting Company v. McCaughan, 3 Cir., 43 F. 2d 503. • • •

"As long as the two law suits were pending the taxpayer's legal rights in the land or its value were unsettled and unknown and the ultimate loss, if any, was contingent and could not be deducted. The Commissioner would have rightly refused a deduction before the loss was definitely ascertained. • • •

"The effect of the litigation was to postpone the fixing of the loss until the year in which the settlement was made."

The Court below attempted to distinguish the *Morton* case, *supra*, on the ground that the Court in that case held that "the validity of the sale was not determined until the litigation ended." We fail to see the distinction. In the present case the amount of the Hartman Corporation's assets, and the value of its cause of action against the directors, was not determined, so far as the petitioner was concerned, until the case was settled and the litigation ended.

In *Re Russel Wheel & Foundry Co.*, 3 B. T. A. 1168, *supra*, the taxpayer had entered into a contract with another corporation to supply it with certain fabricated steel for the erection of a theater. During construction, the building plans were changed and taxpayer claimed it was entitled to the value of the steel it had fabricated, but which the other corporation had not used due to the change in plans. The latter sued taxpayer for damages for delay and taxpayer sued for what it claimed to be the balance due it on its account. Both suits were finally settled by the payment to the taxpayer of $4,250 out of a claimed balance due it of $13,438.62. The Commissioner disallowed the deduction of $9,938.62 (the loss after de-

ducting the settlement figure less $750 counsel fees), and the Board of Tax Appeals reversed, saying (p. 1170):

> "We are satisfied from the evidence that the claim asserted by the taxpayer was bona fide and that the compromise was the result of the suit for damages for failure to perform. It is our opinion that, in these circumstances, the taxpayer sustained a loss at the time of the compromise of the two suits in the amount of the account as carried on its books."

These principles are decisive of the case at bar. In the instant case petitioner was suing the officers and directors of The Hartman Corporation on behalf of the corporation and its stockholders to recover for waste, mismanagement and diversion of its assets. Until it was determined whether or not the corporation would recover in that action, and how much the recovery would be, the value of the petitioner's stock was undetermined and unknown. The ultimate loss, if any, was dependent upon the outcome of that action. Had the case gone to trial and resulted in a judgment in favor of the corporation directing the directors to account for the full amount of the damage caused by their mismanagement there might have been no loss to petitioner whatever. The action was actually settled in 1937. It was that settlement which, for the first time, fixed petitioner's loss. The deduction of the loss in 1937, therefore, was proper.

In *Cooley Butler & La Rue Butler* v. *Commissioner of Internal Revenue*, 45 B. T. A. 593, petitioner claimed that the stock of Idaho Copper Co. became worthless in 1937. The Commissioner claimed that the stock had become worthless prior to 1937. In 1927 the Idaho Copper Co. was placed in receivership. In 1929 the petitioner with the approval of the Court loaned certain money to Idaho Copper Co. to pay off receivership certificates. The loan was secured by the assets of the corporation. In 1931 the petitioner foreclosed the loan, and in 1932 he became

the purchaser of the assets which had been security for the note. The deed of foreclosure was executed in 1933. In 1932 certain stockholders of Idaho Copper Co. filed suit claiming the foreclosure was collusive and fraudulent. The Court decided that the foreclosure was not fraudulent and entered an interlocutory order which was consented to by all parties, which provided for obtaining a lessee for the property and if no lessee was obtained Idaho Copper Co. was to give petitioner a quit claim deed to the property. No lessee was found and on December 8, 1937, pursuant to the agreement embodied in the interlocutory decree, the Company executed a quit claim deed to petitioner. The Board of Tax Appeals decided that the stock of Idaho Copper Co. had a potential value which was not wiped out by the foreclosure sale of the property in 1932 and by the transfer of the property by sheriff's deed to petitioner in 1933, but continued until the final decree in the litigation and the consequent quit claim deed by the company to Cooley Butler in 1937. The Court held that not until the quit claim deed was given to Cooley Butler in 1937 could it have been definitely determined that there would be a loss or that the stock was worthless.

The rule is thus stated in *Olds and Whipple, Inc.* v. *Commissioner* (C. C. A. 2nd), 75 Fed. (2d) 272, 275:

> "A real loss is sustained when all chances or possibilities of collection have been effectively destroyed."

In *Sabath* v. *Commissioner of Internal Revenue,* 100 Fed. (2d) 569, the Court passed upon the question as to the year in which two stocks had become worthless. Petitioner had purchased stock in the Federal Paving Company. The Company had been engaged in paving roads in the states of Illinois and Indiana. Under certain of its contracts the Company lost a great deal of money and as a result became insolvent. In 1925 the Company pre-

sented a claim to the State Highway Department in the sum of $133,000. Thereafter the Company brought suit on its claim, which in 1928 was rejected by the Court of Claims. The Court held that the year in which the stock became worthless was the year in which the Court of Claims denied the Company's claim.

The second stock involved oil company stock which was purchased in 1918 by petitioner. The Company paid dividends until 1925. The company declined in its operations in 1925, 1926, 1927, 1928 and 1929. In 1929 the company abandoned its runs and had no substantial assets remaining over and above liabilities. Petitioner deducted his investment as a loss in 1929. The Board of Tax Appeals disallowed the deduction. The Circuit Court of Appeals reversed, saying, at page 573, *supra*:

> "The action of the petitioner is to be judged by the conduct of a reasonably prudent business man. He is presumed to know what any prudent person ought to know when facts are to be brought to his attention and to act honestly thereon. Avery v. Commissioner, 5 Cir., 22 F. 2d 6, 55 A. L. R. 1277. Only such losses are deductible under the statute as are fixed by identifiable events. United States v. S. S. White Dental Mfg. Co., 274 U. S. 398, 47 S. Ct. 598, 71 L. Ed. 1120. Here petitioner knew that his dividends had become of no considerable value; that the company was abandoning all further operation and that there were no substantial assets remaining. Perhaps he might have foreseen this outcome before 1929; but until that year the company was still in operation, producing oil, and a reasonably prudent businessman would not abandon his interest therein until he received further information that the holdings were abandoned. Under these facts there was no evidence to support a finding that petitioner had failed to prove that his loss was sustained in 1929. True it is that a small dividend of $300, apparently liquidating in character, was paid in 1922, but this in itself is not sufficient to support a finding that the loss was not sustained in the year 1929."

So in the instant case, petitioner did not abandon her interest in the stock of The Hartman Corporation. She employed counsel and advanced substantial sums of money in prosecuting what she considered a meritorious cause of action against the directors for waste and mismanagement. Like a "reasonably prudent business man" she continued to prosecute the Company's cause of action until she finally recovered in 1937 approximately forty per cent of the cost of her stock. In the face of this fact, how can it be reasonably inferred that the stock became worthless in 1932? We respectfully submit that the "identifiable event" from which it could be inferred or argued that the stock had no further value occurred in 1937 when the cause of action was settled. Until the cause of action was disposed of nobody could tell what the outcome of the case would be or how much would be realized upon the trial or settlement of the cause of action. It was the settlement in 1937 which was the "identifiable event" which for the first time fixed the amount of petitioner's loss, and it was that event which thereafter made petitioner's stock worthless.

Thus we have shown that petitioner's stock became worthless in 1937, at the time of the settlement of the cause of action against the directors. At that time petitioner released her interest in the Company's cause of action against the directors, and the Company had no other assets. We have also shown that petitioner invested time and money in prosecuting the Company's cause of action and therefore actually and honestly believed that her stock was not worthless prior to 1937. Applying either the subjective or objective test, petitioner was entitled to deduct from her 1937 income the sum of $19,940 as a loss on her stock in The Hartman Corporation.

The Circuit Court of Appeals relied upon two cases, *Commissioner* v. *John Thatcher & Son*, 76 F. 2d. 900, and *Niagara Share Corp.* v. *Commissioner*, 82 F. 2d. 208.

Neither of these cases is applicable to the instant case. In the *Thatcher* case there was no subsequent recovery by the taxpayer. The loss did not involve the question of the year in which a security became worthless but merely whether an operating loss of the taxpayer should have been deducted in the year in which it was sustained, or in a later year. The taxpayer claimed that the liability of a subcontractor to make good this loss justified the deduction of the loss in a later year as a bad debt. The Circuit Court of Appeals held that the loss could have been deducted in the year in which it was sustained. In addition, the Court pointed out that the taxpayer did not succeed in recovering anything on his claim against the subcontractor.

The Niagara Share case is likewise inapplicable. In that case the taxpayer sustained a loss. The taxpayer contended that certain persons were responsible to him as guarantors of said loss. The guarantors denied liability and their liability was sustained only by a divided court. In that case the taxpayer sought to deduct the loss in the year in which it had been sustained rather than in the year in which it was determined that he was unable to collect the amount from the guarantors. The Court held that the taxpayer could elect to deduct the loss in the year in which it was sustained and any amount recovered from the guarantors would be included as income in the year in which it was recovered. Thus, the decision is in no way applicable to the instant case.

CONCLUSION

For the reasons heretofore assigned, it is respectfully submitted that the decision below was incorrect and should be reversed.

Respectfully submitted,

LOUIS BOEHM,
Attorney for Petitioner.

Appendix

Revenue Act of 1936, c. 690, 49 Stat. 1648:

* * * * * * *

Sec. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * * *

(e) Losses by Individuals.—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

* * * * * * *

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business:

* * * * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 23 (e)—1. Losses by individuals.—Losses sustained by individual citizens or residents of the United States and not compensated for by insurance or otherwise are fully deductible if * * * (b) incurred in any transaction entered into for profit, or * * * (d) if not prohibited or limited by any of the following sections of the Act: * * * section 117, relating to limitation on losses recognized by section 112 upon the sale or exchange of capital assets; * * *

In general losses for which an amount may be deducted from gross income must be evidenced by closed and completed transactions, fixed by identifiable events, bona fide and actually sustained during the taxable period for which allowed. Substance and not mere form will govern in determining deductible losses. * * *

ART. 23 (e)—4. Shrinkage in value of stocks.—A person possessing stock of a corporation can not deduct from gross income any amount claimed as a loss

merely on account of shrinkage in value of such stock through fluctuation of the market or otherwise. The loss allowable in such cases is that actually suffered when the stock is disposed of. If stock of a corporation becomes worthless, its cost or other basis as determined and adjusted under section 113 is deductible by the owner for the taxable year in which the stock became worthless, provided a satisfactory showing is made of its worthlessness. • • •